Roundtable Discussion on the European Commission's Study on Company Taxation

Conference on "Corporate and Capital Income Taxation in the European Union", Mons, 7–8th December 2001

Summary

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In October 2001, the European Commission issued two documents on company taxation: A study prepared by the Commission Services ("Company Taxation in the Internal Market") and a policy Communication from the Commission ("Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities").[1]

The two documents were prepared following a mandate given to the Commission by the Council of the European Union in 1999. Among other things, the mandate asked for the study to illustrate existing differences in effective corporate tax rates; highlight remaining tax obstacles to cross-border economic activities in the Internal Market; highlight the policy issues involved in reducing continuing tax-induced distortions in the Internal Market and examine possible remedial measures. The mandate explicitly stressed that co-operation in the tax policy area was not aiming at uniform tax rates.

In preparing its study, the Commission was assisted by two expert panels. However, in contrast to the Ruding Report of 1992, the final responsibility for the content of the study rests with the Commission Services, rather than with outside experts.

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[1] Both documents can be found on the Commission's web-site under http://europa.eu.int/comm/taxation_customs/taxation/information_notes/tax_saving.htm.

The political context

Before setting out the content of the two Commission documents, and in order to allow a better understanding of the Commission recommendations, it is useful to briefly set out the present political context for taxation policy in the European Union.

To begin with, it needs to be emphasised that the unanimity principle applies to all decisions on tax matters. Against this background, it is not surprising to observe that no new EU legislation on direct taxation has been adopted since 1990. Concerning company taxation more specifically, there was no success in implementing the recommendations of the so-called Ruding Report of 1992, the last major report on company taxation in the EU. The Ruding Report had in fact proposed a far-reaching harmonisation of the corporate tax base, as well as the introduction of compulsory minimum (30%) and maximum (40%) nominal tax rates.

Because decisions on tax matters must be unanimous, no new legislation has been adopted since 1990

Finally, it must be stressed that any Community initiative has to respect Member States' competences in the light of the subsidiarity principle.

The content of the study

In accordance with the mandate, the study prepared by the Commission services covers four main areas of analysis:

1. The calculation and analysis of a wide range of marginal and average effective tax rates for the 15 EU Member States;
2. Identification of the remaining tax obstacles hindering cross-border economic activities in the EU;
3. An analysis of targeted solutions to the different tax obstacles that have been identified;
4. An analysis of so-called comprehensive solutions.

The effects of the existing tax obstacles

The different tax obstacles that have been identified are described in some detail in the study.

However, it might be useful to briefly illustrate the economic effects of these obstacles when seen from a company's perspective. These concern in particular:

- A higher tax burden for trans-national companies compared to otherwise identical national companies (e.g. due to the absence of horizontal cross-border loss compensation)
- Economic double taxation resulting from incompatibilities between national tax systems (e.g. due to inadequacies of the existing Parent/Subsidiary Directive)
- Extra tax burden in case of cross-border economic restructuring (e.g. due to inadequacies of the existing Merger Directive)
- High compliance costs because of the necessity of dealing with up to 15 different tax systems in the EU (e.g. transfer pricing difficulties linked to separate accounting)

Existing tax obstacles place a heavy burden on companies

In principle, the remaining tax obstacles could be removed either by targeted solutions or by comprehensive solutions. This presentation only focuses on the latter type of solutions since these would in principle remove the obstacles altogether in a more unified manner.

Comprehensive solutions

Four options were analysed in the study:

1. Home State Taxation (HST), where all or a group of Member States agree to accept that certain enterprises with operations in more than one Member State could compute their taxable base according to the tax code of their "Home State", instead of according to all the different tax codes of the respective Member States where they have operations.
2. Common Consolidated Base Taxation (CCBT), where some or all Member States would agree on an optional additional tax code applicable to certain types of enterprises operating in more than one Member State.
3. European Corporate Income Tax (EUCIT), where – similar to CCBT – a new single corporate tax would have to be drafted for application across the EU. In the purest form, there would be one single EU-wide tax rate and the revenues would go to the Community budget.
4. Compulsory Harmonisation of the existing fifteen national tax codes in the EU.

All options would offer companies the possibility of using a single tax base for all their EU-wide activities. All, except to a certain extent EUCIT, would require a mechanism for allocating the tax base/tax revenues between Member States. In all cases, except under certain circumstances the EUCIT, Member States would continue to set the tax rates.

None of the four comprehensive approaches appears to offer a perfect solution. Each has its respective advantages and disadvantages, which can be summarised as follows.

Pros and cons of "Home State Taxation"

Pros:

- The approach is based on the Single Market idea of mutual recognition;
- It respects the subsidiarity principle;
- There is no need for unanimous agreement of Community measures, as a sub-group of Member States could start implementing HST;
- There is no need for the time-consuming development of new laws;
- Tax administrations as well as companies can work on the basis of existing tax laws, traditions etc.;
- The details of the proposal are relatively well researched (Stockholm Group);
- It could provide a pragmatic intermediary step in the development of more ambitious approaches.

Cons:

- There is a risk of getting stuck with an unsatisfactory intermediary solution (e.g. like in the case of the transitional VAT system);
- There is a different treatment for companies operating in the same market depending on the location of their parent company (up to 15 home states);
- This could under certain circumstances cause discrimination problems;
- Despite the available research, technical problems remain (for example relating to double-taxation agreements with third countries or the treatment of minority shareholders);
- The responsibility for tax audits and control is unclear;

- There is some reluctance by Member States;
- There is a need to define "home state" and "home state group".

Pros and cons of "Common consolidated Base Taxation"

Pros:
- It is a coherent and systematic approach from an industry perspective;
- There is a common treatment for all participating Member States and companies.

Cons:
- Developing a completely new EU tax base is an extremely complex and time-consuming task;
- Member States would have to administer two tax systems at the same time;
- There could be possible discrimination problems;
- A number of technical problems remain (for example relating to double-taxation agreements with third countries or the treatment of minority shareholders);
- There is a reluctance by Member States, presumably in particular against a common EU tax base that is more attractive than the existing domestic one;
- There are no existing practices, traditions etc.;
- The legal system in case of disputes is unclear (which jurisdiction?).

Pros and cons of a "European Corporate Income Tax"

Pros:
- Similar advantages as CCBT;
- If there were only an EU tax rate, one single effective tax rate would apply across the EU, thus avoiding economic distortions;
- For participating companies the obstacles would be removed.

Cons:
- There are additional political difficulties (link to debate on the EU's own resources system; national sovereignty on tax rates);
- There is the question of who would administer the tax (national tax administrations or a new EU tax administration?);
- There could be possible discrimination problems;
- The new tax system would be time-consuming to develop.

Pros and cons of a "Compulsory Harmonised Tax Base"

Pros:
- Theoretically, this could be 'perfect' for the Single Market;
- It provides one tax base (both for companies and tax administrations);
- There are fewer administrative and compliance costs;
- The regime would be transparent.

Cons:
- Harmonising Member States' existing tax bases is an extremely complex and time-consuming task;
- It would imply other far-reaching harmonisation steps (tax system, EU double-taxation agreement etc.);
- Member States have fundamental objections to a harmonisation approach in the field of company taxation;
- It could be argued that this would be a disproportionate measure in relation to its purpose (of resolving specific tax problems of multinationals).

The pros and cons of the four proposals show the difficulties on the road to tax reform

Commission Conclusions

On the basis of the analysis presented in the Commission Services study, the European Commission has drawn the following policy conclusions. Firstly, a two-track strategy is required, containing both targeted and longer-term comprehensive solutions. Secondly, companies resident in the EU should be provided with (the possibility of) a consolidated corporate tax base for their EU-wide activities. Thirdly, each of the comprehensive solutions has its particular advantages and disadvantages. At this point in time, it is therefore not possible to recommend any particular comprehensive solution. Instead, further analysis and debate is necessary before deciding on the way forward.